

STATE OF DELAWARE
OFFICE OF
AUDITOR OF ACCOUNTS

DEPARTMENT OF EDUCATION

DEBT SERVICE
FISCAL YEAR 2006

AGREED-UPON PROCEDURES ENGAGEMENT

FIELDWORK END DATE: DECEMBER 4, 2006

R. THOMAS WAGNER, JR., CFE, CGFM, CICA
AUDITOR OF ACCOUNTS

Townsend Building, Suite 1
401 Federal Street
Dover, DE 19901
TELEPHONE (302) 739-4241
FACSIMILE (302) 739-2723
www.state.de.us/auditor/index.htm

TABLE OF CONTENTS

Independent Accountant's Report	1
Schedule of Findings	3
Schedule of Prior Year Findings	9
Distribution of Report	10



STATE OF DELAWARE

OFFICE OF AUDITOR OF ACCOUNTS

R. THOMAS WAGNER, JR., CGFM, CFE
AUDITOR OF ACCOUNTS

PHONE: (302) 739-4241
FAX: (302) 739-2723

**INDEPENDENT ACCOUNTANT'S REPORT
ON APPLYING AGREED-UPON PROCEDURES**

The Honorable Valerie A. Woodruff
Secretary
Department of Education
Townsend Building, Suite 2
401 Federal Street
Dover, DE 19901

We have performed the procedures enumerated below, which were agreed to by the Department of Education (DOE) and the following School Districts: Appoquinimink, Brandywine, Caesar Rodney, Cape Henlopen, Capital, Christina, Colonial, Delmar, Indian River, Lake Forest, Laurel, Milford, New Castle County Vocational Technical, Polytech, Red Clay, Seaford, Smyrna, Sussex Technical, and Woodbridge. The procedures were performed solely to assist the specified parties in determining that: (a) tax receipts were properly credited by each School District as authorized by the tax levy and (b) each District's June 30, 2006 debt service balance was sufficient, without being excessive, to pay principal and interest payments for the first four months of Fiscal Year 2007. The Board of Education of each School District is responsible to levy a tax sufficient to make payment of interest and principal on outstanding bonds.

This agreed-upon procedures attestation engagement was performed in accordance with *Government Auditing Standards* (2003), issued by the Comptroller General of the United States and the attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

Our procedures were as follows:

1. For all School Districts, except for the four restructured School Districts within New Castle County, recalculated the real estate tax for current operations, debt service, tuition, and minor capital improvements to verify tax receipts were properly recorded in DFMS.
2. Reviewed the debt service expenditures (principal and interest) to verify they were proper and in accordance with the amortization schedule provided by the Office of State Treasurer.

3. Compared the June 30, 2006, debt service reserve balances to the total required debt service payments for July 1, 2006 through October 31, 2006 to determine whether the debt service reserves were sufficient, without being excessive, to pay the bond principal and interest for the first four months of Fiscal Year 2007.
4. For the four restructured School Districts within New Castle County, tested DOE's September and October 2005 calculations to verify proper allocation of tax revenues.

We were not engaged to and did not conduct an examination, the objective of which would be the expression of an opinion on compliance with specified laws. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the Department of Education and the School Districts identified above and should not be used by those who have not agreed to the procedures and have not taken responsibility for the sufficiency of the procedures for their purposes. However, this report is a matter of public record and its distribution is not limited. This report, as required by statute, was provided to the Office of the Governor, Office of the Controller General, Office of the Attorney General, Office of Management and Budget, and Department of Finance.

R. Thomas Wagner, Jr., CFE, CGFM, CICA
Auditor of Accounts
Office of Auditor of Accounts

December 4, 2006

SCHEDULE OF FINDINGS

Procedure Agreed Upon #1:

For all School Districts, except for the four restructured School Districts within New Castle County, recalculated the real estate tax for current operations, debt service, tuition, and minor capital improvements to verify tax receipts were properly recorded in DFMS.

Finding:

Appoquinimink School District

Appoquinimink School District improperly allocated \$16,401.42 to appropriation 8300 (Cafeteria Account) instead of appropriation 8400 (Minor Cap). The District processed a total of three Cash Adjustment Documents (CA) transferring the funds into the incorrect appropriation.

29 Del Code, §7514 states debt service money received "...shall be deposited by the State Treasurer in a special fund and shall be expended only for school construction in such district."

The error in coding was undetected by the District. A lack of reconciliation and management review contributed to the non-detection of the error. Upon notification by the Office of Auditor of Accounts, the District corrected the error.

Laurel School District

A data entry error by the State of Delaware Treasurer's Office resulted in the improper allocation of \$43,857.93 to appropriation 8000 (Current Expense) instead of appropriation 8100 (Debt Service) for Laurel School District. The District properly coded the source document; however, the Treasurer's Office incorrectly entered the transaction into the State of Delaware Financial Management System (DFMS). Neither the District nor the Treasurer's Office identified and corrected the error.

The Committee of Sponsoring Organizations of the Treadway Commission's *Internal Control - Integrated Framework* identifies reconciliation and management review as two control categories. Reconciliation is designed to check whether two items/computer systems are consistent (i.e. actual payments made agree to payment schedules). Management review requires that a person different than the preparer analyze and perform oversight of activities performed.

Human error resulted in the incorrect data entry of the transaction. The lack of reconciliation and management review resulted in the error going undetected. The incorrect coding caused an eventual shortfall in appropriation 8100 (debt service), which was later covered by a transfer from appropriation 8000 (Current Expense). Upon notification by the Office of Auditor of Accounts, the District corrected the error.

Recommendation:

Appoquinimink School District

Appoquinimink School District implement reconciliation and review processes to verify correct posting of transactions, to identify errors, and to assist in timely correction of errors.

SCHEDULE OF FINDINGS

Laurel School District

Laurel School District implement reconciliation and review processes to verify correct posting of transactions, to identify errors, and to assist in timely correction of errors.

Office of State Treasurer

The Office of State Treasurer implement reconciliation and review processes to verify correct posting of transactions, to identify errors, and to assist in timely correction of errors.

Auditee Response:

Appoquinimink School District

The Appoquinimink School District will implement a reconciliation and review process to verify the correct posting of transactions, identify any errors, and provide a timely correction of errors.

Laurel School District

The Laurel School District will look at the monthly financial reports from the state to make sure that the prior month's tax collections were recorded in the proper appropriations.

Procedure Agreed Upon #2:

Reviewed the debt service expenditures (principal and interest) to verify they were proper and in accordance with the amortization schedule provided by the Office of State Treasurer.

Finding:

The State of Delaware Treasurer's Office incorrectly recorded Brandywine School District's July 2005 principal payments for bond numbers 185 and 189 in the amounts of \$155,635.00 and \$753,906.15, respectively. The total amount of \$909,541.15 was coded to interest payments. Although source documents were properly coded, a data entry error resulted in the incorrect coding in the State of Delaware Financial Management System (DFMS). Neither the District nor the Treasurer's Office identified and corrected the error.

The State of Delaware Treasurer's Office incorrectly recorded Red Clay School District's July 2005 principal payment for bond number 189 in the amount of \$205,670. The payment was coded to interest payments. Although the source document was properly coded, a data entry error resulted in the incorrect coding in the State of Delaware Financial Management System (DFMS). Neither the District nor the Treasurer's Office identified and corrected the error.

The Committee of Sponsoring Organizations of the Treadway Commission's *Internal Control - Integrated Framework* identifies reconciliation and management review as two control categories. Reconciliation is designed to check whether two items/computer systems are consistent (i.e. actual payments made agree to payment schedules). Management review requires that a person different than the preparer analyze and perform oversight of activities performed.

SCHEDULE OF FINDINGS

The lack of reconciliation and management review resulted in incorrect reporting of principal and interest payments in DFMS.

Recommendation:

The Treasurer's Office, Brandywine School District, and Red Clay School District implement reconciliation and review processes to verify correct posting of transactions, to identify errors, and to assist in timely correction of errors.

Auditee Response:

Brandywine School District

The Journal Voucher document was processed by the State Treasurer's Office not the Brandywine School District. The district checked that the correct overall amount of funds were removed from our accounts by the Treasurer's Office, but has never traditionally checked, at the object code level, that the appropriate amounts of interest and principal are removed. The district will periodically check transactions from now on.

Red Clay School District

The Red Clay Consolidated School District notes the finding and will implement a monthly review of transactions posted in the DFMS system against both the source document and the amortization schedule from the State Treasurer's Office. Since most of the payments are posted at the beginning of the month, this review [will occur] within the first week.

Office of State Treasurer

The Office of State Treasurer (OST) will implement a procedure for reconciliation of local share debt service payments with the OST's local share debt service records.

Procedure Agreed Upon #3:

Compared the June 30, 2006, debt service reserve balances to the total required debt service payments for July 1, 2006 through October 31, 2006 to determine whether the debt service reserves were sufficient, without being excessive, to pay the bond principal and interest for the first four months of Fiscal Year 2007.

Finding:

Caesar Rodney School District

Caesar Rodney School District's debt service balance as of June 30, 2006 was \$1,395,447. Principal and interest payments for the period of July 1, 2006 through October 31, 2006 total \$482,186; principal and interest payments for Fiscal Year 2007 (July 1, 2006 through June 30, 2007) total \$1,224,431. The balance as of June 30, 2006 is excessive, as it provides for 100% of principal and interest payments for Fiscal Year 2007. Although the District reduced the debt service tax rate for Fiscal Year 2007, the resulting projected effect on the debt service balance is a decrease of only \$100,000. Projections prepared

SCHEDULE OF FINDINGS

by the District indicate a decrease in the debt service reserve balance of approximately \$100,000 for one year (Fiscal Year 2007), with a projected increase each year thereafter.

Attorney General's Opinion 1W-024 dated July 15, 1975 states, "The power of a district to levy taxes for bonded indebtedness is limited to the amount necessary to pay the interest and annual payment on outstanding bonds, plus 10 percent for delinquencies (14 Del. C., Section 2116, 2118)." Additionally, this opinion affirms that, "A school district may not assess debt service taxes in an amount which exceed that necessary to pay off its bond obligations as they fall due." The Department of Education recommends a 4-month reserve be maintained to provide adequate cash flow.

Lack of reductions in the debt service tax rate resulted in noncompliance with Attorney General's Opinion 1W-024 and unnecessary tax collections from taxpayers within the District.

Christina School District

As of June 30, 2006, Christina School District did not have a sufficient balance in its debt service appropriation to pay bond principal and interest payments for the period July 1, 2006 through October 31, 2006. The debt service balance as of June 30, 2006 was \$3,383,715. Principal and interest payments for the period July 1, 2006 through October 31, 2006 total \$4,184,541. Although tax collections for July, August, and September 2006 are expected to cover the shortfall, a deficit balance is anticipated due to the differences in September between the timing of payments (September 1) and tax collections (approximately September 25).

Attorney General's Opinion 1W-024 dated July 15, 1975 states, "The power of a district to levy taxes for bonded indebtedness is limited to the amount necessary to pay the interest and annual payment on outstanding bonds, plus 10 percent for delinquencies (14 Del. C., Section 2116, 2118)." The Department of Education recommends a 4-month reserve be maintained to provide adequate cash flow.

Insufficient monitoring of the debt service tax rate has resulted in a shortfall. Due to the insufficient monitoring and financial difficulties of the District, the District will need to make special arrangements to meet principal and interest obligations.

Delmar School District

Delmar School District's debt service balance as of June 30, 2006 was \$746,588. Principal and interest payments for the period of July 1, 2006 through October 31, 2006 total \$67,113. Principal and interest payments for Fiscal Years 2007 and 2008 (July 1, 2006 through June 30, 2008) total \$347,141 and \$335,714, respectively. The balance as of June 30, 2006 is excessive, as it provides for 100% of principal and interest payments for Fiscal Years 2007 and 2008. Projections provided by the District, which propose a reduction in the tax rate, indicate a minimal decrease in the debt service balance.

Attorney General's Opinion 1W-024 dated July 15, 1975 states, "The power of a district to levy taxes for bonded indebtedness is limited to the amount necessary to pay the interest and annual payment on outstanding bonds, plus 10 percent for delinquencies (14 Del. C., Section 2116, 2118)." Additionally, this opinion affirms that, "A school district may not assess debt service taxes in an amount which exceed that necessary to pay off its bond obligations as they fall due." The Department of Education recommends a 4-month reserve be maintained to provide adequate cash flow.

SCHEDULE OF FINDINGS

Lack of reductions in the debt service tax rate resulted in noncompliance with Attorney General's Opinion 1W-024 and unnecessary tax collections from taxpayers within the District.

Recommendation:

Caesar Rodney School District

Caesar Rodney School District substantially reduce its debt service reserve by reducing its debt service tax rate. The District monitor the debt service obligations, tax rate, and projected tax base to ensure adequate, but not excessive, funds to meet debt service obligations.

Christina School District

Christina School District establish a sufficient debt service tax rate (based upon projected debt service balances, tax base, and expenditures) to meet principal and interest obligations.

Delmar School District

Delmar School District substantially reduce its debt service reserve by reducing its debt service tax rate. The District monitor the debt service obligations, tax rate, and projected tax base to ensure adequate, but not excessive, funds to meet debt service obligations.

Auditee Response:

Caesar Rodney School District

Caesar Rodney School District plans to attempt another referendum that may propose a transfer of Debt Service Tax to Current Expense Tax and/or may propose another Major Capital Project with an approximate value of \$120 million. The district's local share would be \$24 million. If a Major Capital referendum is successful, the district will use the credit for the current bonds to partially fund the new project and thus reduce the annual reserve. If a Major Capital referendum is not successful, the district will propose to transfer enough Debt Service Tax to Current Expense Tax to reduce the annual reserve to an amount that will cover principal and interest payments for the period of July 1, 2007 through October 31, 2007. If a referendum is not successful, the district will reduce the current Debt Service Tax to ensure the reserve is sufficient, without being excessive, to pay the bond principal and interest for the first four months of FY08 and every year thereafter.

Christina School District

Regarding the amount available for bond payments through 10/31/06: when the tax warrant was prepared in June 2005, we [the District] estimated the State would sell \$21,519,800 in bonds during fiscal year ended 6/30/06 at 4%. The actual amount sold was \$31,519,800. The late sale of the additional bonds by the cash management office wasn't included by Christina School District in calculating its FY 2006 tax warrant, resulting in the shortfall. The district has ensured that a sufficient balance in its debt service appropriation to pay bond principal and interest payments for the period July 1, 2007 through October 31, 2007.

SCHEDULE OF FINDINGS

Delmar School District

The Delmar School District will be going out to referendum in the spring of 2007 and seeking the permission to transfer monies from the debt service to district operating expenses, while lower[sic] the tax rate by at least .5 cents.

SCHEDULE OF PRIOR YEAR FINDINGS

The following schedule summarizes the prior year findings and the status of the prior year findings.

Prior Year Finding	Recommendation	Status of Prior Year Finding
Caesar Rodney School District and Capital School District did not allocate tax receipts in accordance with the approved tax warrant.	The Districts (a) calculate tax receipts based on approved tax warrants and (b) provide oversight to ensure correct allocation of tax receipts.	Implemented
Caesar Rodney School District had an excessive debt service balance as of June 30, 2005.	The District reduce its debt service tax rate.	Partially Implemented. The District reduced the Fiscal Year 2007 tax rate. The balance as of June 30, 2006 remained excessive. See the finding for the District for Procedure Agreed Upon #3.
Indian River School District did not have a sufficient balance in its debt service reserve, as of June 30, 2005, to pay bond principal and interest for the period July 1, 2005 through October 31, 2005. Incomplete or out-dated information was used by the District in the calculation of tax rates for debt service.	The District use current, complete information when preparing calculations for the debt service tax rate.	Partially Implemented. The District increased the Fiscal Year 2007 tax rate to ensure a sufficient balance. However, the District was still using incomplete/inaccurate information in the calculation of the tax rate.

Status Key:

Implemented

The concern has been addressed by implementing the original or an alternate corrective action.

Not Implemented

The corrective action has not been initiated.

Partially Implemented

The corrective action has been initiated but is not complete and the auditor has reason to believe management fully intends to address the concern.

DISTRIBUTION OF REPORT

Copies of this report have been distributed to the following public officials:

Executive Branch

The Honorable Ruth Ann Minner, Governor, State of Delaware
The Honorable Richard S. Cordrey, Secretary, Department of Finance
The Honorable Jennifer W. Davis, Director, Office of Management and Budget
Ms. Trisha Neely, Director, Division of Accounting

Legislative Branch

The Honorable Russell T. Larson, Controller General, Office of the Controller General

Other Elective Offices

The Honorable Joseph R. Biden III, Attorney General, Office of the Attorney General
The Honorable Jack Markell, Treasurer, State Treasurer's Office

Other

Ms. Dorcell S. Spence, Associate Secretary of Education, Finance and Administrative Services,
Department of Education
Mr. Jerry Gallagher, Director, Financial Management, Department of Education
Superintendents, All School Districts